

Message Text

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ACTION EUR-12

INFO OCT-01 ISO-00 AID-05 CIAE-00 COME-00 EB-08 FRB-03
 INR-07 NSAE-00 USIA-06 TRSE-00 XMB-02 OPIC-03
 SP-02 LAB-04 SIL-01 OMB-01 NSC-05 SS-15 STR-04
 CEA-01 PA-01 PRS-01 OES-07 INT-05 FEAE-00 AGRE-00
 L-03 /097 W

-----030974 011707Z /50

R 011430Z AUG 77
FM AMEMBASSY WARSAW
TO SECSTATE WASHDC 9448
INFO AMEMBASSY BONN
AMEMBASSY MOSCOW

C O N F I D E N T I A L SECTION 1 OF 2 WARSAW 5324

E.O. 11652: GDS
TAGS: ECON EFIN PL
SUBJ: POLAND'S DEBT PROBLEMS INTENSIFY

1. SUMMARY: WITH A CONVERTIBLE-CURRENCY DEBT OF AROUND \$12 BILLION, ANNUAL DEBT-SERVICING REQUIREMENTS OF WELL OVER \$2 BILLION, AND A PERSISTENTLY LARGE DEFICIT IN ITS TRADE WITH THE WEST, POLAND'S HARD-CURRENCY PROBLEM IS VERY SERIOUS. TO DEAL WITH THIS SITUATION, POLISH OFFICIALS HAVE BEEN SQUEEZING IMPORTS, PUSHING EXPORTS, AND CONDUCTING A VERY IMAGINATIVE AND ENERGETIC BORROWING PROGRAM. THESE EFFORTS WILL HAVE TO BE FURTHER INTENSIFIED IF A FORMAL RESCHEDULING OF POLAND'S DEBTS IS TO BE AVOIDED.
END SUMMARY.

2. IN MANY WAYS, IT WOULD BE EASIER FOR GOP OFFICIALS TO SEEK FORMAL RESCHEDULING OF THEIR DEBTS THAN TO STEP UP THE ALREADY STRENUOUS EFFORTS TO AVOID SUCH AN OUTCOME. POLAND'S CREDIT RATING IN THE WEST WOULD BE DAMAGED ONLY marginally MORE BY A FORMAL RESCHEDULING THAN BY SOME OF THE EXTRAORDINARY AND UNORTHODOX FINANCING SCHEMES THE POLES HAVE BEEN ENGAGING IN RECENTLY. RELATIVELY SPEAKING, THE CREDIT RATINGS OF POLAND'S COMECON
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NEIGHBORS MIGHT BE MORE SERIOUSLY DAMAGED BY A POLISH RESCHEDULING THAN WOULD THE ALREADY TARNISHED REPUTATION OF POLAND. IT IS NOT LIKELY, HOWEVER, THAT POLAND'S PRIDE IN ITS DEBT-PAYMENT RECORD AND THE SOVIETS' CONCERN ABOUT THEIR OWN CREDIT RATING WILL PERMIT OPTING FOR FORMAL RESCHEDULING UNLESS ALL OTHER POSSIBILITIES HAD BEEN EXHAUSTED.

3. POLAND HAS BEEN ENGAGED IN A DE-FACTO RESCHEDULING OPERATION FOR OVER TWO YEARS. MANY OF THE NON-RESCHEDULING OPTIONS AVAILABLE TO IT HAVE ALREADY BEEN USED, BUT A NUMBER OF POSSIBILITIES STILL REMAIN. AN INCREASING PORTION OF THE NEW CREDITS THE GOP HAS RECEIVED HAS BEEN USED TO COVER THE INTEREST AND PRINCIPAL DUE ON EXISTING LOANS. NEVERTHELESS, POLAND STILL HAS CONSIDERABLE LEEWAY BEFORE IT WOULD HAVE TO MOVE FROM DE-FACTO TO OPEN RESCHEDULING.

4. U.S. AND OTHER WESTERN BANKS STILL REMAIN WILLING TO LEND TO POLAND, EVEN THOUGH THEY EXHIBIT A MUCH MORE CAUTIOUS ATTITUDE THAN PREVIOUSLY. CHASE AND MANUFACTURERS HANOVER ARE NEGOTIATING A \$300-350 MILLION EURODOLLAR CREDIT WHICH WILL BE PRESENTED THIS FALL AS A CONTINUATION OF THE \$240 MILLION COPPER CREDIT WHICH CHASE PUT TOGETHER IN 1975. WE EXPECT THAT THE PROCEEDS OF THIS LOAN, LIKE THAT OF THE FIRST LOAN, WILL BE USED MOSTLY TO MEET THE INTEREST AND PRINCIPAL PAYMENTS ON EXISTING LOANS, RATHER THAN TO MAKE INVESTMENTS IN COPPER MINES OR PROCESSING FACILITIES.

5. ALTHOUGH AN EXPANSION OF COPPER-PRODUCTION FACILITIES IS UNDERWAY, THE BULK OF THESE EXPENDITURES IS IN ZLOTYS AND MUCH OF THE HARD-CURRENCY COSTS INVOLVED HAVE BEEN FINANCED BY SEPARATE SUPPLIER CREDITS. IN ADDITION TO THE TWO CHASE LOANS, POLAND ALSO HAS BORROWED SEVERAL HUNDRED MILLION DOLLARS FROM VARIOUS EUROPEAN COUNTRIES AGAINST FUTURE DELIVERIES OF COPPER. CONFIDENTIAL

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ACCORDING TO PRESS RELEASES, THE PROCEEDS OF THOSE LOANS WERE ALSO TO BE USED FOR COPPER INVESTMENTS, BUT WE SUSPECT THAT THEY WENT MAINLY TO MEET-DEBT-SERVICE REQUIREMENTS. POLAND HAS MADE SIMILAR USE OF ITS COAL DEPOSITS, BORROWING BOTH FOR "INVESTMENT PROJECTS" AND AGAINST FUTURE DELIVERIES OF COAL.

6. CONSIDERABLE AMOUNTS (POSSIBLY OVER ONE BILLION DOLLARS) PROBABLY CAN STILL BE BORROWED AGAINST COPPER AND COAL "PROJECTS" AND DELIVERIES. OTHER BORROWING DEVICES ALSO REMAIN AVAILABLE. WE UNDERSTAND THAT THE FRG IS BEING PRESSED IN CONNECTION WITH THE UPCOMING SCHMIDT VISIT TO MAKE A LARGE LOAN WHICH WOULD BE PAID OFF WITH FUTURE DELIVERIES OF ELECTRIC POWER. NEW THERMO-ELECTRIC PLANTS TO PRODUCE THE POWER WOULD INVOLVE LITTLE FOREIGN EXCHANGE, SINCE MOST OF THE GENERATING EQUIPMENT NEEDED IS PRODUCED IN POLAND OR BY ITS CEMA NEIGHBORS. THE POLES WOULD BE ABLE TO DRAW ON THE CREDIT TO MEET THEIR CURRENT DEBT-SERVICING REQUIREMENTS. IF THE GERMANS AGREE, THE POLES COULD RECEIVE A BILLION DOLLARS OR MORE IN FINANCING FOR THIS PROJECT. SCHMIDT'S PRESSING POLITICAL PROBLEMS WOULD MAKE IT DIFFICULT FOR HIM TO PROPOSE FURTHER ASSISTANCE AT THIS TIME TO THE POLES, ESPECIALLY IN VIEW OF THE GOP'S AGGRESSIVELY ANTI-GERMAN PRESS CAMPAIGN LAST SPRING. HOWEVER, THIS PROPOSAL

COULD BE PACKAGED TO PLEASE ENVIRONMENTAL AND BUSINESS INTERESTS
IN THE FRG AND TO MAKE IT POLITICALLY SALEABLE.

7. POLAND COULD ALSO LINE UP AN ADDITIONAL ONE OR TWO BILLION
DOLLARS BY INSISTING ON LARGE FINANCIAL CREDITS BEFORE AWARDING
BIG PROJECTS TO WESTERN SUPPLIERS. FINANCIAL CREDITS OF 20
TO 30 PERCENT OVER THE FULL FINANCING OF A PROJECT'S HARD-
CURRENCY COSTS WERE RECEIVED IN 1976 FOR LARGE UNDERTAKINGS,
AND THIS PERCENTAGE MIGHT BE PUSHED TO THE 40 OR 50 PERCENT
LEVEL ON FUTURE PROJECTS. IN THE OFFING ARE LARGE DEALS TOTALING
FIVE TO SIX BILLION DOLLARS WHICH WOULD LEND THEMSELVES TO
THIS TREATMENT. SIZEABLE AMOUNTS OF FINANCIAL CREDITS CAN BE
BUILT INTO A PROJECT AS LOCAL COSTS, THUS MEETING THE WESTERN
BANKS' DESIRE TO APPEAR TO BE LENDING TO POLAND ONLY FOR PROJECT
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PURPOSES WHILE IN FACT PROVIDING THE POLES WITH UNTIED FOREIGN
EXCHANGE. MINISTER OF FOREIGN TRADE OLSZEWSKI HINTED BROADLY
TO COMMERCE DAS REICH THAT THE GM LIGHT-VAN PROJECT MIGHT BE
RESURRECTED IF ADEQUATE FINANCIAL CREDITS WERE SUPPLIED IN
ADDITION TO THE EQUIPMENT FINANCING. OLSZEWSKI WAS POLAND'S
MAIN NEGOTIATOR IN PREVIOUS LARGE PROJECTS WITH THE U.K.,
FRANCE, AND THE FRG, ALL OF WHICH HAD LARGE FINANCIAL-CREDIT
PACKAGES ATTACHED.

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SP-02 LAB-04 SIL-01 OMB-01 NSC-05 SS-15 STR-04
CEA-01 PA-01 PRS-01 OES-07 INT-05 FEA-01 AGRE-00
L-03 /098 W

-----041114 021001Z /12/50

R 011430Z AUG 77

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CORRECTED COPY (TEXT)

9. POLAND HAS SECURED FINANCIAL BREATHING ROOM OVER THE PAST TWO YEARS BY TAKING ADVANTAGE OF SLACK DEMAND IN THE WEST TO OBTAIN THREE-TO-FIVE YEAR FINANCING ON IMPORTS OF CONSUMABLES SUCH AS STEEL AND GRAIN, WHICH ORDINARILY ARE PAID FOR ON THREE-TO SIX-MONTH TERMS. RECENTLY, THIS TECHNIQUE HAS BEEN EXTENDED TO CHEMICALS, WHERE POLAND COULD RECEIVE A ONE-TIME FINANCIAL INJECTION OF ABOUT A BILLION DOLLARS IF PAYMENT OF TERMS WERE SWITCHED FROM THE CURRENT 30 TO 90 DAYS TO ONE TO THREE YEARS.

10. GOP AUTHORITIES ARE ALSO HOPING TO USE THE CURRENT GLUT ON THE WORLD GRAIN MARKET TO GET SOFTER FINANCING TERMS FOR THEIR GRAIN IMPORTS. DURING OLSZEWSKI'S VISIT TO CANADA THIS PAST SPRING, THE POLES REPORTEDLY OBTAINED THREE YEAR FINANCING ON GRAIN SHIPMENTS WITH NO PAYMENT ON THE PRICIPAL FALLING DUE UNTIL THE END OF THE THIRD YEAR. THE POLES EXPECT TO OBTAIN COMPETITIVE FINANCING ARRANGEMENTS FROM THE U.S. AS WELL, AND IN RECENT WEEKS HIGH OFFICIALS OF THE MINISTRIES OF FINANCE, FOREIGN
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AFFAIRS, AND FOREIGN TRADE HAVE TOLD VISITING AND RESIDENT USG OFFICIALS THAT THEY WERE INTERESTED IN PL-480 FINANCING OF FOOD IMPORTS. ALTHOUGH NONE OF THE U.S. OFFICIALS GAVE THEIR POLISH INTER-LOCUTORS AND REASON TO EXPECT FAVORABLE ACTION ON PL-480, WE ARE LIKELY TO HEAR MORE ON THIS SUBJECT LATER AS WARSAW'S FINANCING PROBLEM WORSENS.

11. THERE ARE TWO OTHER KINDS OF FINANCIAL ASSISTANCE AVAILABLE TO POLAND FROM VERY DIFFERENT SOURCES. THE FIRST IS FROM THE USSR AND THE SECOND IS THROUGH IMF/IBRD MEMBERSHIP. ALTHOUGH WE HAVE NO PRECISE INFORMATION ON THE AMOUNT AND NATURE OF ASSISTANCE THE SOVIETS HAVE ALREADY GRANTED TO POLAND, WE BELIEVE THEY ARE PROBABLY PREPARED TO EXTEND FURTHER HELP TO PREVENT POPULAR DISTURBANCES OR TO KEEP POLAND FROM DAMAGING THE CREDIT RATING OF ALL CEMA MEMBERS BY BEING FORCED TO AN OPEN RESCHEDULING. VISITING U.S. COMMERCIAL BANKERS HAVE NEARLY GIVEN UP TRYING TO CONVINCE THEMSELVES THAT THE SOVIET UNION IS THE ULTIMATE GUARANTOR OF LOANS TO ANY CEMA COUNTRY AND ARE NOW ARGUING THAT THE CREDIT RATINGS OF ALL CEMA COUNTRIES WILL RISE AND FALL TOGETHER. THE FACT THAT POLAND'S IMPORTS FROM CEMA COUNTRIES SHOT UP BY 22 PERCENT IN THE FIRST HALF OF THIS YEAR, WHILE ITS EXPORTS TO THE SAME COUNTRIES ROSE BY ONLY 12.5 PER-

CENT, PROBABLY SHOWS THAT CONSIDERABLE ASSISTANCE IS
ALREADY FLOWING IN FROM THE SOVIETS. ALTHOUGH JOINING
THE IMF HAS BEEN UNDER CONSIDERATION IN THE GOP FOR SOME
TIME, IT IS NOT LIKELY TO OCCUR WITHOUT
APPROVAL OF THE SOVIETS. AS THE POLISH FINANCIAL SITUATION
TIGHTENS, GOP OFFICIALS COULD ARGUE THAT, UNLESS THEIR
ASSISTANCE NEEDS ARE MET BY THE EAST, THEY WOULD HAVE LITTLE
CHOICE BUT TO JOIN EVEN WITHOUT FULL CEMA CONCURRENCE.
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12. POLISH OFFICIALS REALIZE THAT ALL OF THE ABOVE-
MENTIONED DEVICES ARE MERELY WAYS TO BUY ADDITIONAL
TIME AND THAT THEY DO NOT ELIMINATE THE NEED TO BRING
THEIR HARD CURRENCY TRADE ACCOUNTS INTO BETTER BALANCE.
SUCCESS IN RIGHTING THIS TRADE BALANCE WILL BE ESPECIALLY
DIFFICULT, GIVEN THE SLUGGISH ECONOMIC PERFORMANCE OF
OECD COUNTRIES. NEVERTHELESS, POLISH AUTHORITIES ARE
MAKING SOME SHORT TERM PROGRESS, AS SHOWN BY THE
14.6 PERCENT RISE IN EXPORTS AND 5.4 PERCENT DECLINE
IN IMPORTS FROM HARD CURRENCY COUNTRIES DURING THE
FIRST SIX MONTHS OF 1977. THE OPEC COUNTRIES AND OTHER
MORE PROSPEROUS LDC'S PLAY AN IMPORTANT ROLE IN POLAND'S
PLANS TO IMPROVE ITS CONVERTIBLE CURRENCY TRADE BALANCE.
A MAJOR EFFORT IS UNDERWAY TO INCREASE EXPORTS TO THESE
COUNTRIES AND SOME SUCCESS ALREADY HAS BEEN ACHIEVED.
IN 1976, FOR EXAMPLE, POLAND'S TRADE BALANCE WITH A
NUMBER OF THESE COUNTRIES IMPROVED BY OVER \$200 MILLION.
WESTERN ASSESSMENTS OF POLISH HARD CURRENCY TRADE
BALANCES, WHICH USUALLY EXCLUDE NON-INDUSTRIAL OR NON-
OECD COUNTRIES, WILL HAVE TO BE ADJUSTED TO TAKE THIS
INCREASINGLY IMPORTANT FACTOR INTO CONSIDERATION.

13. COMMENT. THE POLISH AUTHORITIES COULD DECIDE THAT
CONTINUING THE STRENUOUS EFFORT TO AVOID A FORMAL RE-
SCHEDULING EXERCISES IS NOT WORTHWHILE BUT THEY ARE MORE LIKELY TO
KEEP UP THE STRUGGLE TO AVOID THE PUBLIC EMBARRASSMENT OF SUCH
AN EVENT. WE ESTIMATE THAT POLAND STILL HAVE ENOUGH
OPTIONS LEFT TO BUY ITSELF QUITE A FEW MORE MONTHS OF
TIME. WHETHER IT WILL BE ABLE TO USE THAT TIME EFFECTIVELY
TO BRING ABOUT ESSENTIAL IMPROVEMENTS IN ITS TRADE BALANCE
IS STILL FAR FROM CLEAR. FURTHER UNFAVORABLE TRENDS IN
POLAND'S EXPORT PRICES OR IN ECONOMIC RECOVERY IN THE WEST
COULD AGGRAVATE THE SITUATION.

14. IF EXAMINED EXCLUSIVELY FROM THE POINT OF VIEW OF
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CLASSIC BALANCE-OF-PAYMENTS AND DEBT SERVICING CRITERIA,
THE TASK FACING POLAND WOULD APPEAR TO BE NEARLY UN-
MANAGEABLE, AND WE WOULD HAVE TO PREDICT SOME SORT OF
FNANCIAL DISLOCATION IN THE NOT TOO DISTANT FUTURE.
BUT THESE ARE NOT NORMAL TIMES IN POLAND IS NOT ALONE
IN COPING WITH A HEAVY DEBT BURDEN AND A SERIOUSLY
NEGATIVE TRADE BALANCE. MOST LDC'S -- AND A NUMBER
OF DEVELOPED COUNTRIES -- FIND THEMSELVES IN THE SAME
BOAT.

15. THESE COUNTRIES, ALONG WITH POLAND, ARE STRIVING
TO RESTORE FUNDAMENTAL BALANCE IN THEIR ECONOMIIES, BUT THEY
FACE AN UPHILL BATTLE AGAINST TIME UNLESS A GENEROUS
AMOUNT OF OUTSIDE HELP FROM PRIVATE AND PUBLIC SOURCES
IS FORTHCOMING. SOME AD HOC ASSISTANCE MAY BE MADE
AVAILABLE BY INDIVIDUAL BANKS ANXIOUS TO PROTECT THEIR
OUTSTANDING LOANS OR BY THEIR GOVERNMENTS ON A BILATERAL
BASIS. PRESSURES FOR A MORE FUNDAMENTAL SOLUTION
TO THE WORLD'S URGENT DEBT AND MONETARY PROBLEMS ARE, OF COURS,
MOUNTING. PLLAND WOULD BENEFIT FROM ANY GLOBAL DEBT SOLUTION.
END COMMENT.
DAVIES

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Message Attributes

Automatic Decaptioning: X
Capture Date: 01-Jan-1994 12:00:00 am
Channel Indicators: n/a
Current Classification: UNCLASSIFIED
Concepts: DEBTS, DEBT REPAYMENTS, FINANCIAL TRENDS
Control Number: n/a
Copy: SINGLE
Sent Date: 01-Aug-1977 12:00:00 am
Decaption Date: 01-Jan-1960 12:00:00 am
Decaption Note:
Disposition Action: RELEASED
Disposition Approved on Date:
Disposition Case Number: n/a
Disposition Comment: 25 YEAR REVIEW
Disposition Date: 22 May 2009
Disposition Event:
Disposition History: n/a
Disposition Reason:
Disposition Remarks:
Document Number: 1977WARSAW05324
Document Source: CORE
Document Unique ID: 00
Drafter: n/a
Enclosure: n/a
Executive Order: GS
Errors: N/A
Expiration:
Film Number: D770275-0238
Format: TEL
From: WARSAW
Handling Restrictions: n/a
Image Path:
ISecure: 1
Legacy Key: link1977/newtext/t197708108/aaaadonj.tel
Line Count: 302
Litigation Code IDs:
Litigation Codes:
Litigation History:
Locator: TEXT ON-LINE, ON MICROFILM
Message ID: def42150-c288-dd11-92da-001cc4696bcc
Office: ACTION EUR
Original Classification: CONFIDENTIAL
Original Handling Restrictions: n/a
Original Previous Classification: n/a
Original Previous Handling Restrictions: n/a
Page Count: 6
Previous Channel Indicators: n/a
Previous Classification: CONFIDENTIAL
Previous Handling Restrictions: n/a
Reference: n/a
Retention: 0
Review Action: RELEASED, APPROVED
Review Content Flags:
Review Date: 04-Mar-2005 12:00:00 am
Review Event:
Review Exemptions: n/a
Review Media Identifier:
Review Release Date: n/a
Review Release Event: n/a
Review Transfer Date:
Review Withdrawn Fields: n/a
SAS ID: 1426132
Secure: OPEN
Status: NATIVE
Subject: POLAND'S DEBT PROBLEMS INTENSIFY
TAGS: ECON, EFIN, PL
To: STATE
Type: TE
vdkgvwkey: odbc://SAS/SAS.dbo.SAS_Docs/def42150-c288-dd11-92da-001cc4696bcc
Review Markings:
Margaret P. Grafeld
Declassified/Released
US Department of State
EO Systematic Review
22 May 2009
Markings: Margaret P. Grafeld Declassified/Released US Department of State EO Systematic Review 22 May 2009